

## Internal Revenue Service

## Department of the Treasury

District  
Director

Delaware-Maryland District

31 Hopkins Plaza, Baltimore, MD 21201

## PERSON TO CONTACT:

CONTACT TELEPHONE NUMBER:

IN REPLY REFER TO:

DATE: JUN - 9 1997

## CERTIFIED MAIL

Dear Applicant:

We have considered your application for recognition of exemption from Federal income tax under section 501(c)(7) of the Internal Revenue Code and have determined that you do not qualify for exemption under that section. Our reasons for this conclusion and the facts on which it is based are explained below.

The organization incorporated on [REDACTED]

[REDACTED] (hereafter [REDACTED]) is a membership corporation. To become a member one must be at least eighteen years of age and of good moral character. Each member in good standing shall be entitled to one vote on each matter submitted to a vote of the members. Annual dues are \$[REDACTED] plus additional assessments fees to cover significantly expensive sporting events.

Attachment 3 to Form 1024 states that: "[REDACTED] formed to provide recreation and entertainment for the members of [REDACTED]. The services to be provided include volley ball, billiard, satellite presentation of major sporting events not available through other sources. The club will provide food and beverages to members. The club is designed to provide services to its membership. If, however, profits accrue after all expenses have been satisfied, those profits will be donated to [REDACTED]. It is not the intent of the club to enrich the membership, but merely to provide a safe environment for their recreation needs."

"[REDACTED]" is an outgrowth of [REDACTED] (hereafter [REDACTED]). [REDACTED] is a for-profit corporation which holds all of the assets. "[REDACTED]" was formed to permit [REDACTED] to pursue other business opportunities.

Code	Initiator	Reviewer	Reviewer	Reviewer	Reviewer	Reviewer	Reviewer
	5 724		EO: T				
Surname	T. Furr	T. Furr	Smith				
Date	5/29/97	6/10/97	6/9/97				

Form 1037-A (Rev. 8-80) Correspondence Approval and Clearance

Department of the Treasury / Internal Revenue Service

0020 0001



██████████ has a lease agreement with ██████ for the use of the club property at \$6,000.00 a month. In addition to the rental of the building, "██████████" must rent the equipment, from ██████, to continue the activities previously conducted by ██████. The club building/property is owned by ████████████████████, ██████████ and ████████████████████.

Income is derived from fees for services and membership dues. Expenditure are attributable to food/bar sales, entertainment, equipment rental, repairs and operations.

Clarification of "██████████" activities revealed that its membership originally totaled ██████ persons. However, now that renewals are due, the base is down to ██████. Of that ██████, only ██████ persons attended the last meeting.

To establish a membership base, regular customers of ██████ were given free membership. One does not have to be a city resident to become a member of "██████████". This fact is reinforced by the statement that: "a larger number of memberships belong to college students outside of ██████████, ██████████."

The club makes its facility available for public use and for use by members. On occasion, bartenders, wait staff (all former employees of ██████) and beverages are provided by "██████████".

Copies of advertisements, menus, flyers and brochures revealed that "██████████" offers "take-out orders", "happy hour", membership application approval within 24 hours, weekly live entertainment and discount membership coupons.

To determine the fair market rental value of the club, a copy of an independent appraisal was requested by this office. In response, ██████████ submitted a statement that the ██████████ appraised the property at \$██████████. The applicant chose not to provide an actual copy of the appraisal. Thus there is no determining factor to support the "reasonableness" of the rental fees.

Section 501(c)(7) of the Internal Revenue Code provides for exemption for clubs organized for pleasure, recreation, and other non-profitable purposes, substantially all of the activities of which are for such purposes, and no part of the net earnings of which inures to the benefit of any private shareholder. —

Section 1.501(c)(7)-1 of the Income Tax Regulations provides that, in general, this exemption extends to social and recreational clubs which are supported solely by membership fees and assessments. A club which engages in business, such as making its social and recreational facilities available to the general public or selling products and merchandise is not organized and operated exclusively for pleasure and recreational purposes.

Section 1.501(c)(7) of the Income Tax Regulations provides as follows:

- a) The exemption provided by section 501(a) for organizations described in section 501(c)(7) applies only to clubs which are organized and operated exclusively for pleasure, recreation, and other nonprofitable purposes, but does not apply to any club if any part of its net earnings inures to the benefit of any private shareholder. In general, this exemption extends to social and recreation clubs which are supported solely by membership fees, dues, and assessments. However, a club otherwise entitled to exemption will not be disqualified because it raises revenues from members through the use of club facilities or in connection with club activities.
- b) A club which engages in business, such as making its social and recreational facilities available to the general public - is not organized and operated exclusively for pleasure, recreation, and other nonprofitable purposes, and is not exempt under section 501(a). Solicitation by advertisement or otherwise for public patronage of its facilities is prima facie evidence that the club is engaging in business and is not being operated exclusively for pleasure, recreation, or social purposes.

Public Law 94-568 as explained in Senate Report No. 94-1318, published in Cumulative Bulletin 1976-2, page 597, provides that a club, exempt from taxation and described in section 501(c)(7), is permitted to receive up to 35 percent of its gross receipts from a combination of investment income and receipts from nonmember use of its facilities or services, so long as the latter does not represent more than 15 percent of the total receipts. It is further stated that if an organization exceeds these limits, all of the facts and circumstances must be considered in determining whether the organization qualifies for exempt status.

Revenue Procedure 71-17, published in Cumulative Bulletin 1971-1, page 683, establishes recordkeeping requirements for social clubs, to separate nonmember income. If these requirements are met, certain presumptions as to member vs. nonmember income may be made, as outlined in the Revenue Procedure.

In Polish American Club, Inc., v. Commissioner 33 T.C. M. 925 held that said entity's exemption was revoked because the nonmember income received from rental of the club facility resulted in inurement to the benefit of the club members. There was little doubt that the income derived from nonmember functions relieved the members of their financial responsibility.



Revenue Ruling 58-588 published in Cumulative Bulletin 1958-2, on page 265, states an organization formed by several individuals to operate a health, recreational, and social club but whose predominant activity is selling of services for profit to an unlimited number of so-called "members", who have no voice in the management of the club and whose only rights are the use of the club's facilities upon payment of specified fees, is not a tax-exempt social club within the meaning of section 501(c)(7) of the Internal Revenue Code.

Revenue Ruling 60-324 published in Cumulative Bulletin 1960-2, on page, 173, held that a tax exempt social club lost its exemption when the change in its method of operations resulted in the club engaging in a business.

The club in this case was formed for the purpose of operating a social club on a nonprofit basis for the pleasure and recreation of its member and their guests. The club's bylaws provided for the admission of guests only when accompanied by members.

Among other facilities provided for the pleasure and convenience of its members and their guests, the club has a regular club dining room and bar; a private dining room suitable for cocktail parties, small or medium sized parties or luncheons, small wedding receptions or similar private parties; and a ballroom which, when not used for the club's dances, is available for private use by members for larger parties, such as wedding receptions, banquets, debutante dances, and the like.

A considerable number of functions are held at the club which involve the use of the private dining room and the ballroom. Such functions include civic and business meeting, employee parties by business firms, school and alumni banquets and parties, and similar non-club activities. In such cases, negotiations for the use of the club facilities by an organization or group are made with the particular club member sponsoring the organization or group. the member's name is entered on the club records as the party responsible for the behavior of his guests and the protection of club property.

The making of the club's facilities available for use by outside organizations and groups through member-sponsorship arrangements, was permitting, if not actually inviting, the club to do business with the general public.

Revenue Ruling 66-225 published in Cumulative Bulletin 1966-2, on page 227 held that a non-profit corporation which provides entertainment for its members does not qualify for exemption under section 501(c)(7) of the Internal Revenue Code of 1954 where it is controlled by a taxable corporation and operated as an integral part of such corporation's business.

Revenue Ruling 66-360 published in Cumulative Bulletin 1966-2, on page 228, held that a national sorority that was created and controlled by a business corporation engaged in furnishing services and supplies to the sorority and its member chapters did not qualify for exemption under IRC 501(c)(7).

[REDACTED]

The business corporation controlled the sorority and member chapters by reason of its control over the National sorority's governing body. The corporation used this control to carry on a commercial enterprise consisting of furnishing services and supplies to the National sorority, its chapters, and individual members.

Based upon the facts presented, we have determined that you do not meet the operational test of 501(c)(7) of the Code.

#### ISSUE 1

As in Revenue Rulings 55-558, [REDACTED] has a limited number of persons who are involved in the day-to-day operations and management of the Club. In reality, only the 25 person, less than 1% of your members, are actual "members" for 501(c)(7) purposes. All others are transient individuals using the club for the services provided, such as, happy hours, meal/beverages, live entertainment, private parties and such. "[REDACTED]" is actually doing business with the public. Hence all income received from your so-called members is non-member income which inured to the benefit of the actual members by relieving them of their financial burden.

#### ISSUE II

[REDACTED] formed [REDACTED] solely for its benefit. 1) [REDACTED] retained all assets and charged [REDACTED] rent for use of its facility, which reduced the financial responsibility of the property owner by using [REDACTED] as a conduit for [REDACTED]. 2) All employees of [REDACTED] were employed by [REDACTED], thereby alleviating the for-profit of all tax obligations. [REDACTED] is an integral part of [REDACTED] and does not warrant exemption. Revenue Rulings 60-360/66-225 SUPRA

#### ISSUE III

We have determined that you are similar to the entities described in Revenue Ruling 60-324 and Polish American Club. We hold that [REDACTED] is, in fact, subterfuge doing business with the public. This fact is supported by your low membership dues, broad membership requirement, membership reduction coupons and advertisement to secure patronage and nonmember use of the facility, whether by member sponsorship or direct rental.



[REDACTED]

Therefore, we have concluded that you do not qualify for exemption from Federal income tax as an organization described in section 501(c)(7) of the Code. In accordance with this determination, you are required to file Federal income tax returns on Form 1120.

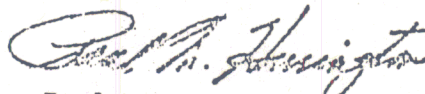
If you do not agree with our determination, you may request consideration of this matter by the Office of Regional Director of Appeals. To do this you should file a written appeal as explained in the enclosed Publication 892. Your appeal should give the facts, law, and any other information to support your position. If you want a hearing, please request it when you file your appeal and you will be contacted to arrange a date. The hearing may be held at the regional office, or, if you request, at any mutually convenient district office. If you will be represented by someone who is not one of your principal officers, that person will need to file a power of attorney or tax authorization with us.

If you don't appeal this determination within 30 days from the date of this letter, as explained in Publication 892, this letter will become our final determination on this matter.

Appeals submitted which do not contain all the documentation required by Publication 892 will be returned for completion.

If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely,



Paul M. Harrington  
District Director

Enclosure: Publication 892